STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105

Date May 8, 2002 **RH02021588**

INITIAL STATEMENT OF REASONS

Credit Property Insurance and Credit Unemployment Insurance

INTRODUCTION

California's Insurance Commissioner proposes the adoption of Title 10, Chapter 5, Subchapter 4.10, Article 1 through Article 8, Sections 2670.1 through 2670.24, regulations titled "Rates for Credit Property Insurance and Credit Unemployment Insurance." The regulations are described below. The purpose of the proposal is to implement, interpret, and make specific the provisions of California Insurance Code §779.36 pertaining to credit property insurance, joint credit property insurance, credit unemployment insurance, and joint credit unemployment insurance. (Hereafter both credit property insurance and joint credit property insurance are included in references to "credit property insurance," and both credit unemployment insurance and joint credit unemployment insurance are included in references to "credit unemployment insurance.") The Commissioner proposes the adoption of the regulations pursuant to the authority vested in him by Sections 779.21, 779.36, 12921, and 12926 of the California Insurance Code, *Credit Insurance General Agents Association v. Payne*, 16 Cal.3d 651 (1976), and *20th Century v. Garamendi*, 8 Cal.4th 216 (1994).

NECESSITY OF REGULATION

This rulemaking proceeding addresses rates for credit property insurance and credit unemployment insurance, the two lines of insurance cited in Insurance Code §779.36 which are also subject to rate regulation under Proposition 103 (Insurance Code §§1861.01 et seq.). In general, credit property insurance pays to repair or replace personal property pledged or offered as collateral for securing a personal or consumer loan, or personal property purchased under an installment sales agreement or through a credit transaction. Credit property insurance provides coverage for loss or damage to the personal property caused by the perils set forth in the credit property insurance policy. Credit unemployment insurance generally provides coverage for periodic payments or payment of an outstanding balance on a specific loan or other credit transaction while the debtor is "involuntarily unemployed" as defined in the policy.

Credit insurance is sold to consumers when they are obtaining loans or purchasing goods or other personal property on credit. Credit insurance is often sold to credit card holders by way of written offers mailed to them with their credit applications or monthly credit card statements. Generally the lender or creditor offers a package of coverages to the consumer, composed of lines such as credit property, credit unemployment, credit disability, credit life, or credit family leave insurance. The consumer must purchase the entire package of coverages or no coverage at all. In this way the choice of coverages purchased is made by the lender or creditor, not the consumer. Consumers cannot comparison shop for credit insurance because it is not sold separately from the lender or creditor with which the consumer is doing business.

Rates for credit insurance historically have been high compared to other lines of insurance. Loss ratios are low in view of the premium charged for coverage. The problem of high rates is compounded by the "reverse competition" marketing system used to sell coverage. Credit insurers sell credit insurance group policies, known as "master policies," to the lenders, credit card companies, or retailers offering goods on credit to consumers. These businesses then sell credit insurance to consumers on behalf of the insurers. The consumer receives a "certificate of insurance" to evidence coverage, but usually does not receive a copy of the master policy. Because the insurance products are sold by insurers to credit card companies or other businesses rather than to the consumers who ultimately buy coverage, insurers compete for business by providing ever-increasing commissions and other compensation to the credit card companies and lenders to induce them to sell the insurers' products to consumers. Insurers which want to lower their rates are unable to find lenders or creditors willing to sell their coverages to the public because lower rates would generate lower commissioners to the lenders. The high commissions and other compensation charges are ultimately passed on to consumers, resulting in *higher* premiums for coverage. The more competition there is, the higher the premiums are.

Before 2000, Insurance Code §779.36 contained some provisions governing the rates that insurers could charge the public for credit life insurance and credit disability insurance, but its provisions were not effective in reducing rates, and the statute contained no controls on the rates insurers could charge for credit property insurance or credit unemployment insurance. In 1999 the Legislature amended to statute, largely in response to a March 1999 report by Consumers Union and the Center for Economic Justice titled "Credit Insurance: The $2 Billion A Year Rip-Off," subtitled "Ineffective Regulation Fails to Protect Consumers" (the "Report"). The Report described how the "reverse competition" marketing system generates high rates for credit property insurance and credit unemployment insurance relative to the benefits provided by the coverages. The Report also detailed numerous objectionable practices by the credit insurance industry in selling these coverages and resolving claims. In response, the Legislature amended §779.36 to add rate control provisions for credit property insurance and credit unemployment insurance as well as credit life insurance and credit disability insurance.

The law governing credit property insurance and credit unemployment insurance rates is now set forth in Insurance Code §779.36 and Proposition 103 (Insurance Code §§1861.01 et seq.). The provisions of Proposition 103 apply prior approval rate regulation to these lines of insurance, and the provisions of §779.36, as amended by Statutes of 1999, Chapter 413 (AB 1456), §1, contain rate regulation requirements specifically for credit property insurance, joint credit property insurance, credit unemployment insurance, and joint credit unemployment insurance. Although regulations exist which implement the prior approval provisions of Proposition 103, there are no regulations which implement the provisions of Insurance Code §779.36 which govern credit property insurance and credit unemployment insurance.

Insurance Code §779.36 as amended requires the Commissioner to adopt regulations "that become effective no later than January 1, 2001, specifying prima facie rates based upon presumptive loss ratios, with rates which would be expected to result in a target loss ratio of 60 percent, or any other loss ratio as may be dictated after applying the factors contained in this subdivision, for each class of …credit unemployment [and] credit property…insurance." The statute includes "joint credit property insurance" and "joint credit unemployment insurance" within its rate control provisions. Section 779.36 requires the Commissioner to make the insurers' actual annual loss ratios available to the public each year.

The Commissioner proposes the adoption of Title 10, Chapter 5, Subchapter 4.10, Article 1 through Article 8, §2670.1 through 2670.24 on a permanent basis. The purpose of the regulations is to implement, interpret and make specific provisions of the California Insurance Code, including but not limited to, §779.36. The regulations establish prima facie rates for credit property insurance, joint credit property insurance, credit unemployment insurance, and joint credit unemployment insurance as required by California Insurance Code §779.36. The regulations also require insurers to report actual annual loss ratio data to the Department of Insurance so that the Commissioner can make this information available to the public.

This rulemaking action pertains only to the fixing of "rates, prices or tariffs." Under Govt. Code Sec. 11343(a)(1) it is exempt from Office of Administrative Law approval.

IDENTIFICATION OF STUDIES RELIED UPON

The Department has reviewed and considered the March 1999 report by Consumers Union and the Center for Economic Justice titled "Credit Insurance: The $2 Billion A Year Rip-Off," subtitled "Ineffective Regulation Fails to Protect Consumers" in proposing the adoption of the regulations. The Department has also reviewed and considered a report generated by the Department of Insurance Rate Specialist Bureau titled "Credit Property & Credit Unemployment, Premium & Loss Exhibit, 1992-1998," with its 1999 addendum. In addition, the Department has gathered information from numerous credit property insurance and credit unemployment insurance rate filings, some of which were used as the basis for the regulations' benchmark programs.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

The proposed regulations do not mandate the use of specific technologies or equipment.

ALTERNATIVES

Insurance Code §779.36 requires the Commissioner to promulgate rate regulations which impose the rate controls set forth in the proposed regulations. The Commissioner has determined that no alternative of which he is aware would be more effective in carrying out the purpose for which the regulations are proposed or would be as effective and less burdensome to affected private persons than the proposed regulations.

ECONOMIC IMPACT ON SMALL BUSINESS

Insurers are not "small businesses" under Govt. Code Sec. 11342(h). However, "small businesses" may comprise some part of the distribution chain of credit property insurance and credit unemployment insurance, either as "creditors" (usually, small retailers) or as insurance producers. The Department believes that most businesses affected by the regulations are excluded from the definition of "small business" under Government Code §11342(h)(2). However, to the extent some "small businesses" may be affected by the proposed regulations, these businesses receive compensation for their credit insurance activities, and may well receive reduced compensation as a result of the rate reductions mandated by the proposed regulations. The Department is unaware of any existing data on the aggregate credit insurance compensation paid to "small businesses" in California. The Department has not identified any alternatives to the proposed regulations which would lessen the impact on small businesses. To the extent any "small businesses" are affected by the regulations, this will be a result of the rate restrictions imposed by Insurance Code §779.36 and not the regulations themselves, which merely implement the terms of the statute.

ECONOMIC IMPACT ON BUSINESSES AND INDIVIDUALS, JOBS, AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Department has calculated the economic impact of the proposed regulations by calculating the effect of the regulations on premium written in California in 1999, the most recent year for which annual data is available. In 1999 credit property insurers wrote approximately $70 million of premium in California. The Department estimates that the regulations will decrease the amount of the premium written by these insurers by approximately 75%, or $52,500,000. This would reduce the total credit property insurance premium written in California to approximately $17,500,000 per year. The Department expects the regulations will have a similar effect on credit unemployment insurance premium written in California. In 1999 credit unemployment insurers wrote approximately $180 million of premium in California. The Department estimates that the regulations will decrease the amount of the premium written by these insurers by approximately 75%, or $135,000,000. This will reduce the total credit unemployment insurance premium written in California to approximately $45,000,000 per year.

The premium reductions will affect insurers and other businesses in the chain of distribution such as lenders and retailers selling goods on credit. These businesses will incur one-time costs associated with complying with the new rates. These costs will vary widely based upon the type of business and distribution system involved and cannot be readily estimated. For example, insurers will have to make new rate filings in order to comply with Insurance Code §779.36. However, since these insurers are already subject to the rate approval requirements of Proposition 103 (Insurance Code §1861.01 et seq.) they have made rate filings in the past and they can make the rate filings required by the regulations without unusual expense or disruption. Businesses receiving commissions, acquisition costs, or other similar expenses from insurers may receive reduced compensation.

The proposed regulations will take approximately $187,500,000 annually from the pockets of lenders and retailers (in the form of compensation) and the credit insurance industry. It will put that $187,500,000 directly into the pockets of consumers to spend on additional goods and services as they choose. One can only speculate as to the effect of this shift on the aggregate creation or elimination of jobs within the state of California, the creation of new businesses or the elimination of existing businesses in the State, or the expansion of businesses currently doing business within California. However, to the extent this transfer will have any overall effect on the huge California economy, the effect will probably be salutary.

The proposal will not have an adverse impact on the ability of California businesses to compete with businesses in other states. All insurers selling credit property insurance and credit unemployment insurance in California will be subject to the requirements of the proposed regulations, regardless of whether they are California companies or out-of-state companies. Moreover, to the extent the regulations provide consumers with annual savings of approximately $187,500,000, the regulations may increase competitiveness within the state because this money will be returned in some fashion to the California economy.

The changes wrought by the regulations will take place as a result of the restrictions on premium imposed by Insurance Code §779.36 and not the regulations themselves, which merely implement the terms of the statute. Given these facts, the Department has determined that the regulations themselves will not have a significant adverse economic impact on business, including the ability of California businesses to compete with businesses in other states.